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## Letter Ruling 08-7: Taxation of Qualified Settlement Fund

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March 28, 2008

You request a letter ruling on behalf of \*\*\*\*\* ("Fund") that for Massachusetts tax purposes, the Fund is not an entity subject to tax, and that irrespective of its tax status, the domicile of the Fund is determined by reference to the location of the court exercising jurisdiction over the Fund.

### I. Facts

The following is your representation of the facts upon which we base our letter ruling. The Fund is a qualified settlement fund ("QSF"), as that term is defined in Internal Revenue Code ("Code") section 468B(g) and Treasury Regulation section 1.468B-1 et seq. For Massachusetts tax purposes, the Fund asserts that it is not considered to be either a domestic or foreign corporation.

The Fund was established pursuant to an order of the United States District Court for the District of Massachusetts ("Court") granting judgment against the defendants in the case of \*\*\*\*\*. This case dealt with violations of federal securities law. Pursuant to the Court's order of judgement, the defendants were ordered to deposit monetary damages into an interest-bearing account with the Court Registry Investment System ("CRIS") of the above-referenced Court. The Fund does not have property, payroll or sales, as described in G.L. c 63, § 38, within or without Massachusetts. The Fund has generated income for the 2006 tax year. Your firm has been appointed Tax Administrator for the Fund.

CRIS is an investment repository maintained by the Administrative Office of the United States Courts in which payments from United States court cases are deposited and invested in Treasury securities or other interest bearing accounts. The Administrative Office provides the Clerk of the Court with reports of the assets held in CRIS. The U.S. Securities and Exchange Commission ("SEC") will develop a plan by which assets of the Fund will be distributed to claimants.[\[1\]](#) However, any such plan is subject to the approval, rejection, or modification by the Court. The Court has ultimate authority over the disposition of the Fund.

### II. Discussion of Law

#### A. Federal Law

Internal Revenue Code § 468B provides special rules for designated settlement funds. Among them, section (b)(1) states that a designated settlement fund is taxed for federal purposes at the rate equal to the maximum rate in effect for trusts. Under section (b)(5), a designated settlement fund is treated as a corporation for purposes of procedure and administration. Moreover, Code § 468B(g) discusses other funds that are similar to designated settlement funds and requires regulations to determine their taxability. One such fund is a qualified settlement fund.

Treas. Reg. § 1.468B-1(a) defines a qualified settlement fund as “a fund, account, or trust that satisfies the requirements of paragraph (c) of this section.” Treas. Reg. § 1.468b-1(c) provides as follows:

(c) Requirements. A fund, account, or trust satisfies the requirements of this paragraph (c) if –

(1) It is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

(2) It is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability –

(i) Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (hereinafter referred to as CERCLA), as amended, 42 U.S.C. 9601 et seq.; or

(ii) Arising out of a tort, breach of contract, or violation of law; or

(iii) Designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) The fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Finally, under Treas. Reg. § 1.468B-2(a), and (k), a qualified settlement fund is taxed at the highest rate applicable to trusts under I.R.C. § 1(e) but is treated as a corporation for purposes of procedure and administration.

## B. Massachusetts Law

There is no provision in Massachusetts General Laws that directly corresponds to Code § 468B and its related regulations concerning the taxation of designated and qualified settlement funds. Thus, in order to make a determination as to the taxability of the Fund for Massachusetts purposes, it is necessary to first determine what type of entity the Fund is for Massachusetts purposes.

As stated in the facts applicable to this ruling request, the Fund is neither a domestic nor foreign corporation for Massachusetts tax purposes within the meaning of G.L. c. 63, § 30.

For Massachusetts tax purposes, a “corporate trust” is defined as “any partnership, association or trust, the beneficial interest of which is represented by transferable shares.” G.L. c. 62, § 1(j). In the instant case, this requirement is not satisfied because, except for certain administrative costs, the assets of the Fund are dedicated to claimants of the civil action and, thus, the beneficial interest in those assets cannot be transferred to anyone other than the claimants.

Because the Fund is not classified for Massachusetts tax purposes as a domestic or foreign corporation or as a corporate trust, it must be classified as either a partnership or trust. See LR 04-2; LR 03-4. The Fund was established through a court order in accordance with Treas. Reg. § 1.468B-1 and not a partnership agreement. Further, the Fund is not carrying on a profit-making business; rather, it holds monies designated by the Court that will be used to pay claimants of the civil action. For these reasons, the Fund is not a partnership; rather it is to be classified as a trust for Massachusetts tax purposes.

The tax treatment of inter vivos or “living trusts” for Massachusetts purposes is governed by General Laws chapter 62, section 10. Such trusts are either characterized as resident inter vivos trusts or non-resident inter vivos trusts. A resident inter vivos trust generally requires at least one trustee to be a resident of Massachusetts. G.L. c. 62, § 10(c). Additionally, it requires the grantor to be either a Massachusetts resident when the trust was created or to reside in Massachusetts during any part of the year for which the income is computed. *Id.* Under the facts presented here, there is no conventional grantor or trustee of the Fund. However, the Fund was established pursuant to an order of the Court, which is located in Massachusetts and has jurisdiction over the Fund. In addition to creating the Fund, the Court has control over the Fund’s investments (by virtue of the fact it ordered the assets of the Fund to be deposited into an account with CRIS), as well as how such assets will be disposed. Accordingly, the Court, pursuant to its authority, is acting as the de facto grantor and trustee of the Fund. In addition, the domicile of the de facto grantor and trustee is Massachusetts. Thus, the Fund is a Massachusetts resident inter vivos trust. See *Harrison v. Commissioner of Corporations and Taxation*, 272 Mass. 422, 428 (1930).<sup>[2]</sup> See also *Harvard Trust Company v. Commissioner of Corporations and Taxation*, 284 Mass. 225 (1933), citing *Harrison*.

A Massachusetts resident inter vivos trust is subject to tax in Massachusetts to the extent its income is accumulating for a Massachusetts resident or deemed Massachusetts resident and its income is over \$100 and is subject to General Laws chapter 62. G.L. c. 62, § 10(a); G.L. c. 62C, § 6. However, you state that the assets of the Fund are invested in Treasury securities and other interest bearing accounts. For purposes of General Laws chapter 62, Massachusetts gross income is federal gross income, with certain modifications. G.L. c. 62, § 2(a). General Laws chapter 62, section 2(a)(2)(A) deducts from Massachusetts gross income interest on obligations of the United States to the extent such interest is included in federal gross income. To the extent that the Fund’s accumulated income is from interest on investments in U.S. Treasury securities, such income would be exempt from Massachusetts taxation if it is included in federal gross income.<sup>[3]</sup> See also LR 93-12. To the extent that the Fund’s accumulated income is not from a source exempt from Massachusetts taxation, then the Fund’s accumulated income would be taxable for Massachusetts income purposes.

Very truly yours,

/s/Navjeet K. Bal

Navjeet K. Bal  
Commissioner of Revenue

NKB:MTF:rmh

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<sup>[1]</sup> The Court may also, when appropriate, approve the payment of federal taxes, as well as reasonable fees and expenses for tax compliance services provided by your firm. Such payments are made from assets of the Fund.

<sup>[2]</sup> “The situs of intangible property held in trust...is fixed in the place where the testamentary trust was created and established and is being administered under direction of its court.”

<sup>[3]</sup> If the claimants of the Fund are not Massachusetts residents or deemed Massachusetts residents then any Massachusetts source income earned by the Fund that is includable in the federal gross income of such claimant by reason of Internal Revenue Code sections 652 and 662 would be

taxable to the claimant for Massachusetts income tax purposes. G.L. c. 62, § 10(g), (h).